CANADA

NATIONAL ENERGY BOARD

REASONS FOR DECISION

In the Matter of a Public Hearing
Respecting Tariffs and Tolls to be Charged,
the Financing of the Pipeline, and Other Related Matters
of

FOOTHILLS PIPE LINES (YUKON) LTD.

JUNE 1980

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June 1980

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<u>NATIONAL ENERGY BOARD</u>

IN THE MATTER OF the National Energy Board Act and the Regulations made thereunder, and the Northern Pipeline Act; and

IN THE MATTER OF a public hearing respecting tariffs and tolls charged by Foothills Pipe Lines (Yukon) Ltd., the financing of the pipeline and other related matters.
File No. 1510-2-24

HEARD AT Ottawa, Ontario on May 29, 1980.

BEFORE:

C.G. Edge	Presiding Member
L.M. Thur	Member
R.B. Horner	Member

APPEARANCES:

John Lutes	) Foothills Pipe Lines (Yukon) Ltd.
John Hopwood	) Alberta Gas Trunk Line Company Limited
E.B. McDougall	) Northwest Alaskan Pipeline Company
L.H. Pilon	) TransCanada PipeLines Limited
E.B. McDougall	) Northwest Pipeline Corporation
J.E. Phillips	) Consolidated Natural Gas and) Northern Natural Gas Company
J.H. Smellie	) Dome Petroleum Limited
G.A. Connell Mr. Hughes	) Gulf Canada Resources Inc.)
J.B. Ballem, Q.C.	) Canadian Petroleum Association
K.J. MacDonald	) National Energy Board

The National Energy Board, by Order No. PO-7-RH-2-79, on 29 May 1980, re-opened the public hearing respecting tariffs and tolls to be charged by Foothills (Yukon), the financing of the pipeline and other related matters, with the specific purpose of considering the effect, if any, which the Board's decision in Phase IV(b) on the starting date of the tariff might have on the Project Risk Premium component in the Incentive Rate of Return, as approved by the Board in its Decision in Phase III dated November 1979.

The Project Risk Premium was defined on page 4 of Appendix B of the Reasons for Decision in Phase III as follows:

> "Project risk premium means the premium to compensate investors for the construction and completion risks unique to the Northern Pipeline Project, which, when added to the operation phase rate, equals the non-incentive rate."

The chief difference between the mainline tariff approved by the Board in Phase I and that approved in Phase IV(b) would appear to relate to the potential difference in cash flow in the year before Alaska gas begins to flow and in the year after it begins to flow. In the Phase III proceedings, in the unlikely event that there was up to a year's delay in the completion of Alaska facilities, and no party had agreed to provide the funds, it was not entirely clear if the tariff would begin two months after Leave to Open was granted for the pipeline in Canada or if the Allowance for Funds Used During Construction (AFUDC) would continue to be capitalized during the delay of up to one year. The issue was to be addressed in the Phase IV(b) proceedings. If there were a delay of up to two months in the start of the tariff due to imperfect coordination of the completion of the facilities in Canada with those in the United States, under the Phase I tariff, interest expense and return on equity would be capitalized and no depreciation would be taken. In the year after the start of the tariff, the Phase I tariff provided for a "minimum bill" and an "interim rate" if Alaska gas did not flow at contracted volumes. This would mean that the return on equity and possibly some other costs would be capitalized.

The National Energy Board, by Order No. RO-7-RH-2-79, on 29 May 1980, re-opened the public hearing respecting tariffs and tolls to be charged by Foothills (Yukon), the financing of the pipeline and other related matters, with the specific purpose of considering the effect, if any, which the Board's decision in Phase IV(a) on the starting date of the tariff might have on the Project Risk Premium component in the Incentive Rate of Return, as approved by the Board in its Decision in Phase III dated November 1979.

The Project Risk Premium was defined on page 4 of Appendix B of the Reasons for Decision in Phase III as follows:

> "Project risk premium means the premium to compensate investors for the construction and completion risks unique to the Northern Pipeline Project, which, when added to the operation phase rate, equals the non-incentive rate."

The chief difference between the mainline tariff approved by the Board in Phase I and that approved in Phase IV(a) would appear to relate to the potential difference in cash flow in the year before Alaska gas begins to flow and in the year after it begins to flow. In the Phase III proceedings, in the unlikely event that there was up to a year's delay in the completion of Alaska facilities, and no party had agreed to provide the funds, it was not entirely clear if the tariff would begin two months after leave to open was granted for the pipeline in Canada or if the Allowance for Funds Used During Construction (AFUDC) would continue to be capitalized during the delay of up to one year. The issue was to be addressed in the Phase IV(b) proceedings. If there were a delay of up to two months in the start of the tariff due to imperfect coordination of the completion of the facilities in Canada with those in the United States, under the Phase I tariff, interest expense and return on equity would be capitalized and no depreciation would be taken. In the year after the start of the tariff, the Phase I tariff provided for a "minimum bill" and an "interim rate" if Alaska gas did not flow at contracted volumes. This would mean that the return on equity and possibly some other costs would be capitalized.

The Project Risk Premium in the Phase III Decision was as follows:

Zone 1	- 1.90 percentage points
Zones 2 - 5	- 1.75 percentage points
Zones 6 - 9	- 1.50 percentage points

In its evidence, Foothills (Yukon) reiterated that it would build the pipeline only if it were paid a full cost of service tariff as approved by the Board in its Phase IV(b) Decision or, alternatively, if it were paid the Phase I tariff with a supporting financing arrangement which could yield the same cash flow as the Phase IV(b) full cost of service tariff. On the other hand, Foothills (Yukon) admitted that it was averse to book earnings not received in cash immediately in that it needed cash to pay dividends as opposed to book income generated by the capitalization of the return on the equity component of AFUDC. Neither Foothills (Yukon)'s policy witnesses nor the expert financial advisers were willing to quantify the effect on return on equity of this averseness to not receiving cash earnings because of the delay in the start of the full cost-of-service tariff. Understandably, Foothills (Yukon) was reluctant to agree that a reduction in the risk premium was appropriate.

In the opinion of the Board, the Project Risk Premium is primarily related to the risk of non-completion of the whole of the pipeline both in Canada and in the United States. This risk would appear to be largely unchanged by the change in the tariff from that approved in the Phase I Decision to the tariff in Phase IV(b). In the former, there was a potential period of 14 months when the full return on equity might not be received as cash immediately. This period could be composed of a delay of up to two months in the coordination of the completion of the facilities in the United States after the Canadian section of the pipeline was ready for service as well as part or all of the following year in which a minimum bill or interim rate could apply. During this period, if these conditions prevail, the return on equity not received under the tariff would be capitalized to be recovered in subsequent years.

In addition, it is possible that a delay of up to one year could occur in the completion of the facilities in Alaska if there were unusual climatic or other conditions which prevented the completion of the processing and transmission facilities on schedule. It is not clear at this time whether the Phase I tariff would operate in this period or whether the costs of carrying the investment in Canada would be capitalized as AFUDC.

Taking the combined period of one year in advance of and one year after the flow of Alaska gas, it is clear that Foothills (Yukon) would be in a preferred position in terms of cash earnings under the Phase IV(b) tariff compared with the tariff approved earlier. However, in the Board's view, the delay in receiving cash in the Phase I tariff would not give rise to any significant risk to the rate of return on equity since the AFUDC capitalized would be recovered with carrying charges in the cost-of-service tariff subsequently paid by shippers. In addition, the special conditions provided for in the Phase I tariff might never arise, or there might be only a small probability of them occurring, if the Alaska facilities are completed on schedule and the quantity of gas transmitted approximates contracted volumes immediately after the start-up of facilities.

Taking all of the above factors into account and recognizing that the Project Risk Premium is primarily related to the risk of non-completion of the whole of the pipeline and is therefore not materially affected by the change in the tariff, and that Alberta gas is likely to still be transmitted in prebuilt facilities in the start-up period when Alaska gas begins to flow, thus reducing the need for a minimum bill and an interim rate, the Board finds that the project risk premium should be slightly reduced, as follows:

Zone 1	- by 0.15 percentage points, to 1.75 percentage points
Zones 2 - 5	- by 0.15 percentage points, to 1.60 percentage points

No change in the rate for Zones 6 to 9 is warranted.

The centre rate for the incentive rate of return under the Phase IV(b) full cost-of-service tariff will be changed from the Phase I tariff as follows:

	Phase I %	Phase IV(b) %
Zone 1	18.5	18.35
Zones 2 - 5	18.25	18.10
Zones 6 - 9	17.90	17.90

Since both the Phase I and Phase IV(b) tariffs have been approved by the Board and it is not known at this time which one will come into effect, the IROR regulations will provide for both situations.

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The foregoing, together with the Proposed Regulations pursuant to Section 36 of the Northern Pipeline Act, which form Appendix B of the Phase III Decision, as amended by this Decision, set forth our Reasons for Decision and our Decision in this matter.

C.G. Edge
Presiding Member

L.M. Thur
Member

R.B. Horner
Member